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# **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**(Required Supplementary Information)**

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## Management's Discussion and Analysis

In this section of the State of South Carolina's annual report, we provide a narrative overview and analysis of the State's financial performance for its accounting year (*fiscal year*) that ended June 30, 2002. Please read it together with (1) the Comptroller's *Letter of Transmittal* at the front of this report and (2) the financial statements, which follow this section.

The Governmental Accounting Standards Board's *new financial reporting model* required the State to present its financial statements differently this year. Because the new model required significant changes in the content and structure of our financial statements, much of the financial information is not easily comparable to prior years. However, in future years, we will be able to provide comparisons that will go further toward explaining the State's financial position and results of operations.

### Overview of the Financial Statements

This discussion and analysis provides an introduction to the State of South Carolina's basic financial statements, which include the following parts: (1) *government-wide financial statements*, (2) *fund financial statements*, (3) *component unit financial statements*, and (4) *notes to the financial statements*. This report also contains certain *required supplementary information* and other supplementary information.

### Government-wide Financial Statements

The government-wide statements are *new* to State government reporting as a result of the new financial reporting model. They present a longer-term view of the State's finances *as a whole*, using *accrual-basis accounting*—the same accounting methods that most businesses use. The basic government-wide financial statements are on pages 30 through 34 of this report.

There are two government-wide financial statements:

***Statement of net assets:*** This statement presents information on *all* of the State's assets and liabilities, both short-term (*current*) and long-term (*non-current*). In addition, the statement reports the difference between assets and liabilities as *net assets*. Over time, increases or decreases in net assets may indicate whether the State's financial health (*financial position*) is strengthening or weakening. However, the statement of net assets does not tell the whole story. To assess the State's overall financial health, you would also need to consider factors such as the State's economy and the condition of its *capital assets* such as its buildings and *infrastructure* (roads and bridges).

***Statement of activities:*** This statement presents information showing how the State's overall net assets changed during the year. The State reports a change in its net assets as soon as an underlying event occurs that would cause a change. The statement of activities accounts for all current-year revenues and expenses, regardless of when the State received or paid cash. Although governments compile the statement of activities using accounting

methods similar to businesses, this statement's format is quite different from the format of a business's income statement. The statement of activities can help to show how much it costs the State to provide various services. It also can help to show the extent to which each government function covers its own costs through user fees, charges, or grants. The *net revenue (expense)* column on the far right of this statement shows how much a particular function relies on taxes and other general revenues to finance its programs.

The government-wide statements report three different kinds of *activities*:

***Governmental activities:*** Most of the State's basic services are included here, such as general administration, education, health and environment, social services, administration of justice, and intergovernmental (State aid to local governmental entities, including aid to the State's public school system). Taxes (primarily income and sales taxes) and federal grants finance most of these services.

***Business-type activities:*** These activities usually recover all, or a significant portion, of the costs of their services or goods by charging fees to customers. The Higher Education Fund (State-supported colleges and universities), Unemployment Compensation Fund, the State Housing Authority, and the Education Assistance Authority are the most significant of South Carolina's business-type activities.

***Component units:*** Although component units are legally separate from the State, the State's elected officials are financially accountable for them. The Public Service Authority (Santee-Cooper, an electric utility company), the State Ports Authority, the Connector 2000 Association, Inc. (which operates the Southern Connector, a toll road), and the Lottery Commission are the State's major component units. Some financial information for these component units is included in this report. You also can obtain complete financial statements for these component units from their respective administrative offices (see Note 1a of the notes to the financial statements).

### Fund Financial Statements

The fund financial statements on pages 36 through 55 of this report provide detailed information about the State's most significant funds—not the State as a whole. Funds are accounting devices that the State uses to track specific funding sources and spending for particular purposes. South Carolina, like other governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The State reports three types of *funds*:

***Governmental funds:*** The State reports most of its basic services in governmental funds. Governmental funds account for activities that the State reports as *governmental activities* in its government-wide statements. These funds focus on *short-term* inflows and outflows of expendable resources. The balances remaining at the end of the year help determine whether a fund has more or less financial resources available to spend in the near

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future. Because the governmental fund statements lack the additional long-term focus of the government-wide statements, we provide a reconciliation that explains the relationship (or differences) between the two kinds of statements. By comparing the two kinds of statements and examining the reconciliation, you may better understand the long-term impact of the State's near-term financing decisions.

The basic governmental fund statements are on pages 36 through 43 of this report.

**Proprietary funds:** Proprietary funds charge customers for the services they provide—whether they are outside customers (*enterprise funds*) or other State agencies or other governments (*internal service funds*). Proprietary funds use *accrual basis accounting* like businesses. The State reports all of its enterprise funds as *business-type activities* in the government-wide statements. However, because our internal service fund operations primarily benefit governmental funds, they are included as *governmental activities* in the government-wide financial statements.

The basic proprietary fund statements are on pages 44 through 53 of this report.

**Fiduciary funds:** The State is the trustee, or *fiduciary*, for its employees' retirement plans. The State also is responsible for other assets that, because of a trust agreement, it can use only for trust beneficiaries. We *exclude* these activities from the State's government-wide financial statements because the State cannot use these assets to finance its operations. The State is responsible for ensuring that the net assets it reports in fiduciary funds are used for their intended purposes.

The basic fiduciary fund statements are on pages 54 and 55 of this report.

### Component Unit Financial Statements

The *Government-wide Financial Statements* section above lists the State's major component units. More detailed financial statements for these component units are on pages 56 through 59 of this report.

### Notes to the Financial Statements

Immediately following the financial statements are *notes* that help explain some of the information in the financial statements and provide more detailed data. The notes on pages 60 through 115 are necessary to fully understand the financial statements.

### Required Supplementary Information

This section includes certain *required* reporting information that supplements the basic financial statements. Included in this section is a schedule that compares the State's legally adopted budget for the General Fund with actual revenues collected and expenditures paid for the year. Following the

schedule, at the end of the notes to the required supplementary information, is a reconciliation that helps explain the differences between the *budgetary-basis* General Fund and the *GAAP-basis* General Fund that is reported in the governmental fund statements. This section also includes schedules related to the State's National Guard Pension System. This required supplementary information is on pages 117 through 123 of this report.

### Supplementary Information

In addition to the required elements above, we have prepared *combining financial statements* that provide more detail of the State's *nonmajor* governmental, proprietary, and fiduciary fund types. The nonmajor funds, when added together, are included in single columns on the *fund financial statements*, one for the nonmajor governmental funds and another for the nonmajor enterprise funds. We have also presented combining financial statements for the nonmajor discretely presented component units. The combining statements are on pages 125 through 169 of this report.

### Government-wide Financial Analysis

*Exhibits 1 and 2* summarize the State's overall financial position and results of operations for the past year based on information included in the government-wide financial statements.

Because this is our first year for reporting the State's finances *as a whole* using accrual-basis accounting, prior year comparative information is not available. However, beginning next year, comparative data will be available, and we will report it in this section of our comprehensive annual financial report.

Exhibit 1  
State of South Carolina's Net Assets as of June 30, 2002  
(Expressed in Thousands)

	Governmental Activities	Business-type Activities	Total
<b>Assets</b>			
Current and other assets.....	\$ 5,947,937	\$ 3,478,269	\$ 9,426,206
Capital assets.....	10,178,240	2,205,705	12,383,945
<b>Total assets.....</b>	<b>16,126,177</b>	<b>5,683,974</b>	<b>21,810,151</b>
<b>Liabilities</b>			
Long-term liabilities.....	4,297,085	2,000,558	6,297,643
Other liabilities.....	2,778,287	669,215	3,447,502
<b>Total liabilities.....</b>	<b>7,075,372</b>	<b>2,669,773</b>	<b>9,745,145</b>
<b>Net Assets</b>			
Invested in capital assets, net of debt.....	7,621,846	1,551,604	9,173,450
Restricted.....	2,308,147	1,291,069	3,599,216
Unrestricted.....	(879,188)	171,528	(707,660)
<b>Total net assets.....</b>	<b>\$ 9,050,805</b>	<b>\$ 3,014,201</b>	<b>\$ 12,065,006</b>

### Net Assets

As we noted earlier, net assets may serve, over time, as a useful indicator of the State's financial position. For the 2001-2002 accounting year, the State's combined net assets totaled \$12.065 billion. However, all of those net assets either were invested in capital assets (such as buildings, roads, and bridges) or were restricted for specific purposes. The remaining *unrestricted* net assets—resources

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available for future spending—reported a *deficit* balance of \$707.660 million.

The largest portion of the State's net assets (76.0%) reflects its investment in capital assets (for example, buildings, roads, bridges), less any related debt used to acquire those assets that is still outstanding. The State uses these capital assets to provide services to citizens; consequently, they are *not* available for future spending. Further, the State cannot sell the capital assets themselves to pay off the related debt because it needs the assets for its operations; so it must find other resources to pay off the debt.

*Restricted* net assets make up 29.8% of the State's net assets. These resources generally are available for future spending but are subject to external restrictions (such as bond covenants, federal government grant restrictions) or restrictions imposed by enabling State legislation or through State constitutional provisions. The State's largest restricted balances include tobacco settlement bond proceeds (restricted primarily for health-related programs), capital improvement bond proceeds (restricted for various capital projects), and loan program funds (restricted primarily for local government water and sewer projects).

The overall *negative* unrestricted net assets balance resulted from the \$879.188 million deficit that the governmental activities reported. That deficit does not necessarily mean that the State lacks resources to pay its bills in the near future. Rather, this deficit was largely due to: (1) \$765.457 million in long-term debt that the State incurred to finance capital assets that are not on the State's financial statements because they belong to local governments (see Note 4b in the notes to the financial statements for a more detailed description), and (2) the State's reporting of the non-capital portion of net assets for most of its governmental activities' special revenue funds as *restricted*.

The State's *business-type activities*, on the other hand, reported a *positive* \$171.528 million unrestricted net asset balance. This resulted from net positive balances of \$376.623 million that the Higher Education Fund and certain other enterprise funds reported. However, that positive balance was offset by a \$205.095 million deficit balance for the State's Patients' Compensation Fund, a nonmajor enterprise fund that provides medical malpractice insurance to any public or private health care provider within the State.

Exhibit 2  
State of South Carolina's Changes in Net Assets—Primary Government  
For the Fiscal Year Ended June 30, 2002  
(Expressed in Thousands)

	Governmental Activities	Business-type Activities	Total
<b>Revenues</b>			
Program revenues:			
Charges for services.....	\$ 1,744,736	\$ 2,158,394	\$ 3,903,130
Operating grants and contributions.....	4,472,482	732,800	5,205,282
Capital grants and contributions.....	514,815	28,650	543,465
General revenues:			
Individual income tax.....	2,357,050	—	2,357,050
Retail sales and use tax.....	2,788,909	—	2,788,909
Other taxes.....	1,211,085	—	1,211,085
Unrestricted grants and contributions.....	37,744	—	37,744
Unrestricted investment income.....	79,119	—	79,119
Tobacco legal settlement.....	88,290	—	88,290
Other.....	70,137	—	70,137
<b>Total revenues.....</b>	<b>13,364,367</b>	<b>2,919,844</b>	<b>16,284,211</b>
<b>Expenses</b>			
Governmental activities:			
General government.....	\$ 1,749,351	\$ —	\$ 1,749,351
Education.....	920,695	—	920,695
Health and environment.....	3,888,356	—	3,888,356
Social services.....	798,409	—	798,409
Administration of justice.....	693,478	—	693,478
Resources and economic development.....	221,644	—	221,644
Transportation.....	340,405	—	340,405
Intergovernmental.....	3,807,548	—	3,807,548
Other.....	71,883	—	71,883
Business-type activities:			
Higher education.....	—	2,256,818	2,256,818
Unemployment compensation benefits.....	—	526,954	526,954
Financing of housing facilities.....	—	125,422	125,422
Financing of student loans.....	—	36,748	36,748
Medical malpractice insurance.....	—	78,949	78,949
Patriots Point development.....	—	6,717	6,717
Insurance claims processing.....	—	1,467	1,467
Higher education institution support <sup>a</sup> .....	—	717,480	717,480
Other.....	—	28,362	28,362
<b>Total expenses.....</b>	<b>12,491,769</b>	<b>3,778,917</b>	<b>16,270,686</b>
<b>Excess (deficiency) before transfers and special and extraordinary items.....</b>	<b>872,598</b>	<b>(859,073)</b>	<b>13,525</b>
Special and extraordinary items.....	—	(6,851)	(6,851)
<b>Net transfers.....</b>	<b>(862,126)</b>	<b>862,126</b>	<b>—</b>
<b>Increase (decrease) in net assets.....</b>	<b>10,472</b>	<b>(3,798)</b>	<b>6,674</b>
<b>Net assets, beginning of year.....</b>	<b>9,040,333</b>	<b>3,017,999</b>	<b>12,058,332</b>
<b>Net assets, end of year.....</b>	<b>\$ 9,050,805</b>	<b>\$ 3,014,201</b>	<b>\$ 12,065,006</b>

<sup>a</sup> The higher education institution support activity represents associations, foundations, and authorities created for the benefit of the State's higher education institutions.

### Changes in Net Assets

The State's *combined* net assets were virtually unchanged, increasing \$6.674 million, or less than 0.1% over the prior year (as restated).

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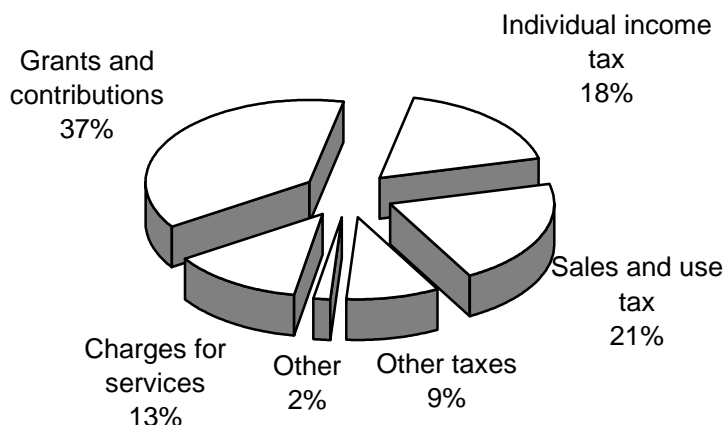
### Governmental Activities

Net assets of the State's governmental activities increased by \$10.472 million, or 0.1%. Governmental activities' revenues were derived mostly from taxes (47.5%); grants and contributions, including federal aid (37.3%); and charges for goods and services (13.1%). *Exhibit 3* illustrates the sources of revenues that these activities reported.

Governmental activities' expenses were mostly associated with services provided for health and environment (31.1%), intergovernmental (30.5%), general government (14.0%), and education (7.4%). *Exhibit 4* compares the cost of these services with their *program revenues*—revenues derived directly from the program itself or from parties outside the State's taxpayers or citizenry. The difference between the two represents the *net cost* of these

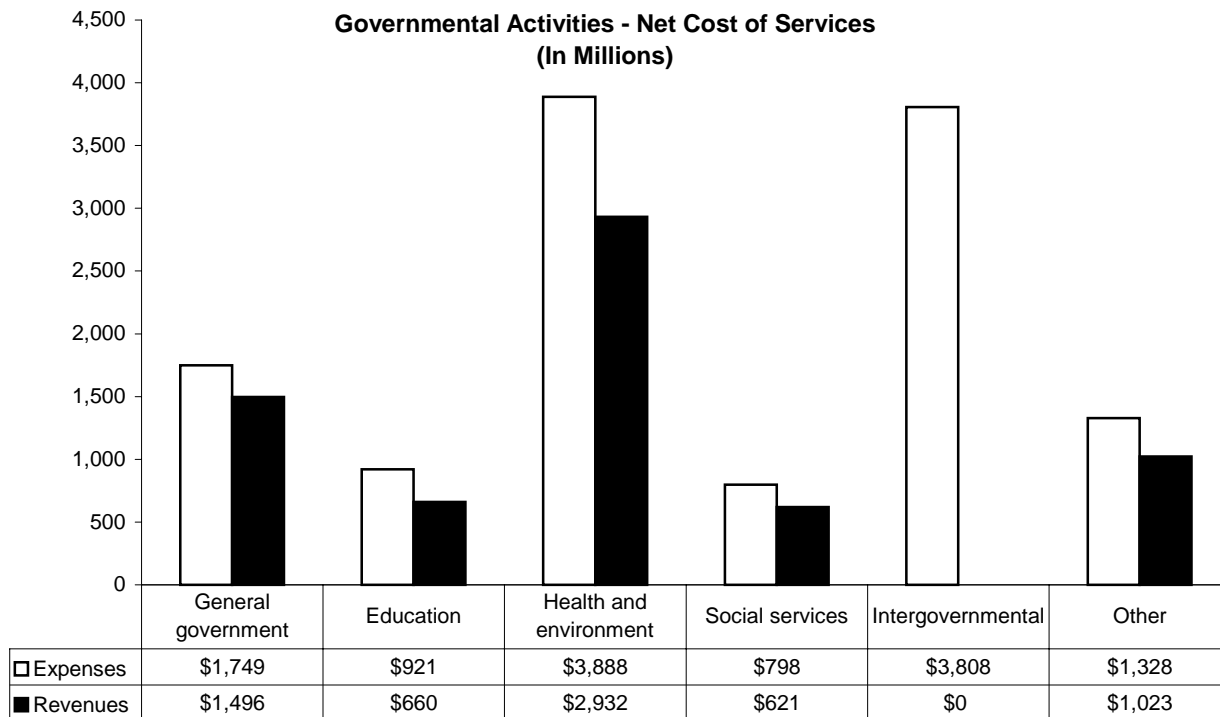
services that taxes and other general revenues financed. Intergovernmental expenses of \$3.808 billion represent aid provided to local governments, including local school districts; taxes and other general revenues entirely supported these expenses. This aid includes formula-based State revenue sharing, aid to local school districts for public education, and subsidies to reimburse counties for the State's residential property tax relief program. For the accounting year ended June 30, 2002, the State used \$5.760 billion in tax and other general revenues to finance the net cost of all services that the State's governmental activities provided. Governmental activities reported \$862.126 million in net transfers to the State's business-type activities, most of which represents support provided to the State's public colleges and universities.

*Exhibit 3*  
**Governmental Activities Revenues**



## Management's Discussion and Analysis

Exhibit 4



### Business-type Activities

Net assets of the State's business-type activities declined \$3.798 million, or less than 0.1%.

Business-type activities' revenues included charges for services (73.9%) and grants and contributions (including federal aid) (26.1%). Business-type activities' expenses were mostly to provide higher education services and support (78.7%), unemployment compensation benefits (13.9%), and housing services (3.3%).

Most business-type activities are self-supporting. Tuition and student fees, research and other grants (both private and governmental), and other charges primarily pay for the services that the Higher Education Fund provides. The Higher Education Fund, however, receives substantial resources (primarily transfers of annual appropriations) from the State's governmental activities. Essentially, net transfers to the Higher

Education Fund represent the cost of educational services that taxes and other general revenues of governmental activities support.

### Financial Analysis of the State's Funds

The State of South Carolina uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. When the State adopted the new governmental financial reporting model, the focus changed from reporting funds by type to reporting *major funds*. Because of this change, we cannot easily compare this year's amounts to last year's amounts. However, we will provide such comparisons in future years.

### Governmental Funds

Exhibit 5 shows the components of fund balance for the State's various governmental funds as of June 30, 2002.

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Exhibit 5  
State of South Carolina's Governmental Fund Balances as of June 30, 2002  
(Expressed in Thousands)

	General Fund	Departmental General Operating	Local Government Infrastructure	Department of Transportation Special Revenue	State Tobacco Settlement	Nonmajor Governmental Funds	Total Governmental Funds
Reserved.....	\$ 67,611	\$ 737	\$ 1,371,276	\$ 11,427	\$ —	\$ 137,680	\$ 1,588,731
Unreserved, designated.....	—	—	—	179,350	—	134,538	313,888
Unreserved, undesignated.....	(207,562)	243,209	(118,633)	—	668,826	440,860	1,026,700
<b>Totals.....</b>	<b>\$ (139,951)</b>	<b>\$ 243,946</b>	<b>\$ 1,252,643</b>	<b>\$ 190,777</b>	<b>\$ 668,826</b>	<b>\$ 713,078</b>	<b>\$ 2,929,319</b>
 Change from prior year...	 \$ (400,894)	 \$ 20,076	 \$ 155,529	 \$ (176,472)	 \$ (62,924)	 \$ (25,210)	 \$ (489,895)
Percentage change.....	(153.6%)	9.0%	14.2%	(48.1%)	(8.6%)	(3.4%)	(14.3%)

As the exhibit shows, at June 30, 2002, the State's governmental funds' ending fund balance was \$2.929 billion, which represents a decrease of \$489.895 million (or 14.3%) from the prior year (as restated). Almost half of this total (45.8%) makes up the *unreserved* fund balance—the amount available for spending in the coming year. The remaining fund balance, or 54.2%, is *reserved* and is *not* available for future appropriation because it is accessible only for specific purposes. The following paragraphs discuss the major governmental funds that had significant changes in fund balance:

The *General Fund* is one of two large State operating funds. This fund includes resources that pay for the services that the State traditionally has provided to its citizens. These resources, such as taxes, are accounted for in the General Fund unless State law requires them to be accounted for in another fund. The General Fund includes resources that appear in the *General Funds* column in the Appropriation Act as well as some unbudgeted resources. At June 30, 2002, total fund balance for the General Fund was a *negative* \$139.951 million. However, because a portion of this balance was reserved for spending in the 2002-2003 accounting year, the unreserved fund balance was *negative* \$207.562 million.

Fund balance decreased by \$400.894 million (or 153.6%) from last year, in part because State individual income tax collections fell with the slumping economy and corporate income tax

collections fell as a result of offering increased credits as an incentive for economic development in rural areas.

The *Local Government Infrastructure Fund* accounts for grants, loans, and other financial assistance to local governments for *infrastructure* purposes (such as roads, bridges, sewer systems, and water systems). Resources of this fund include certain motor fuel taxes, federal funds, contributions from local governments, and transfers from other funds. The \$155.529 million (14.2%) increase in fund balance during the current year resulted primarily from an increase in bond proceeds and an increase in the amount of funding that the Department of Transportation provided to the State Infrastructure Bank.

The *Department of Transportation (DOT) Special Revenue Fund* accounts for various gasoline taxes, fees, fines, and federal grant resources. The DOT uses these resources to pay for its general operations, which include highway maintenance, regulation, and construction of public highways and bridges. The \$176.472 million (48.1%) decrease in fund balance resulted primarily because the DOT spent bond proceeds received in the previous year.

### Proprietary Funds

Exhibit 6 shows the components of net assets for the State's various proprietary funds.

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Exhibit 6

## State of South Carolina's Proprietary Fund Net Assets as of June 30, 2002 (Expressed in Thousands)

Fund Net Assets	Enterprise Funds						Internal Service Funds
	Higher Education	Unemployment Compensation	Housing Authority	Education Assistance Authority	Nonmajor Enterprise	Total Enterprise	
Invested in capital assets (net of related debt).....	\$ 1,458,934	\$ —	\$ 105	\$ 61	\$ 92,504	\$ 1,551,604	\$ 124,119
Restricted, expendable.....	199,119	674,721	212,100	122,385	35,447	1,243,772	157,168
Restricted, nonexpendable...	28,396	—	—	—	18,901	47,297	165
Unrestricted.....	269,842	—	87	1,033	(91,891)	179,071	(75,489)
<b>Totals.....</b>	<b>\$ 1,956,291</b>	<b>\$ 674,721</b>	<b>\$ 212,292</b>	<b>\$ 123,479</b>	<b>\$ 54,961</b>	<b>\$ 3,021,744</b>	<b>\$ 205,963</b>
 Change from prior year	 \$ 154,274	 \$ (120,862)	 \$ 12,767	 \$ 4,655	 \$ (47,089)	 \$ 3,745	 \$ (39,618)
Percentage change.....	8.6%	(15.2%)	6.4%	3.9%	(46.1%)	0.1%	(16.1%)

The State has two kinds of proprietary funds: enterprise funds and internal service funds. *Enterprise funds* are reported as business-type activities in the government-wide financial statements. Enterprise funds sell goods or services primarily to parties outside of State government.

The only major enterprise fund that experienced a significant decline in fund balance during the accounting year ended June 30, 2002, was the *Unemployment Compensation Fund*. This fund collects assessments from employers and uses these resources to pay benefits to unemployed persons who are legally eligible to receive such benefits. The fund's net assets decreased \$120.862 million (15.2%) from the preceding year. The reason for the decrease was that the fund paid out more benefits because the economic downturn put more people out of work. In addition, an Emergency Unemployment Compensation Program extended the benefit period for eligible persons up to an additional thirteen weeks.

South Carolina's *internal service funds* provide certain services (including maintenance, insurance, printing, data processing, and motor pool services) and some goods (such as office supplies) primarily to other State funds but sometimes to local governments as well. The objective of an internal service fund is to charge its customers for the costs of the services or goods that it provides. Because internal service funds primarily benefit State government, South Carolina reports them as governmental activities in the government-wide financial statements and eliminates their net assets (or deficits) in the government-wide statement of activities.

### Budgetary General Fund Highlights

Differences between the original budget and the final amended budget were substantial.

The State's *Board of Economic Advisors (BEA)* is responsible for forecasting revenues for the budget. State law requires that the BEA meet each

year in November and February to review revenue collections and to adjust its estimates if necessary. During the year, the BEA revised original revenue estimates downward by \$412.764 million, or 7.5%. These downward revisions were the result of a slowing State and national economy as well as unrealistic revenue forecasts.

If the BEA reduces revenue projections significantly, the State's *Budget and Control Board* (the Board) is responsible for reducing spending to keep the budget in balance. In response to the BEA's revised estimates, the Board reduced appropriations by \$426.587 million by eliminating a 2% set-aside for capital and nonrecurring items and by ordering 6.52% cuts for most State agencies. Appropriations had to be increased by \$25.793 million during the year to fund certain State-mandated programs that were underestimated in the Appropriation Act.

Even with these substantial reductions to the original budget, actual revenues at June 30, 2002, were \$193.500 million less than expected and \$255.176 million less than expenditures. The State was forced to expend *all* of the remaining \$62.809 million from its "rainy day account," leaving a balance of zero in that account. Despite these actions, the State ended the year with a budgetary fund *deficit* of \$104.447 million. See the Budgetary Reporting subsection of the *Required Supplementary Information* section within this report for a detailed budgetary comparison schedule.

### Capital Assets and Debt Administration

#### Capital Assets

At the end of the 2001-2002 accounting year, the State had \$12.384 billion invested in capital assets. This represented a net increase (including additions and deductions) of \$1.048 billion, or 9.2%, over the previous accounting year.



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*Exhibit 7*  
**State of South Carolina's Capital Assets**  
 (Net of Depreciation, Expressed in Thousands)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2001	2002	2001	2002	2001	2002	2001-2002
Land and improvements.....	\$ 576,619	\$ 648,770	\$ 167,853	\$ 184,799	\$ 744,472	\$ 833,569	12.0%
Infrastructure.....	5,106,604	5,174,989	—	—	5,106,604	5,174,989	1.3%
Buildings and improvements.....	826,588	844,698	1,427,251	1,479,836	2,253,839	2,324,534	3.1%
Vehicles.....	202,007	178,065	6,808	8,688	208,815	186,753	(10.6%)
Machinery and equipment.....	135,702	121,666	171,052	176,442	306,754	298,108	(2.8%)
Works of art and historical treasures.....	957	974	19,266	19,064	20,223	20,038	(0.9%)
Construction in progress.....	2,480,223	3,202,996	199,579	331,024	2,679,802	3,534,020	31.9%
Intangible assets.....	7,433	6,082	8,471	5,852	15,904	11,934	(25.0%)
<b>Total.....</b>	<b>\$ 9,336,133</b>	<b>\$ 10,178,240</b>	<b>\$ 2,000,280</b>	<b>\$ 2,205,705</b>	<b>\$ 11,336,413</b>	<b>\$ 12,383,945</b>	<b>9.2%</b>

Most of the capital asset additions during 2001-2002 were for construction in progress, primarily for State highway system expansion projects. Highway projects in progress of the State's Department of Transportation at June 30, 2002, included the following:

- Construction of a cable stay span bridge over the Cooper River to replace the existing truss bridges connecting the City of Charleston and the Town of Mount Pleasant.
- Construction of the Carolina Bays Parkway, a new 20-mile north/south route along South Carolina's Grand Strand. The parkway opened in December 2002.
- Various road-widening projects to alleviate traffic congestion and increase safety on the State's interstates and highways.

The State's investment in land also increased significantly during the 2001-2002 accounting year, because it acquired rights-of-way for highway construction and widening projects and it purchased several parcels of land and easements for conservation purposes.

See Note 8 in the notes to the financial statements within this report for additional information on the State's capital assets.

### Long-term Debt

At the end of the accounting year, the State had \$6.069 billion in bonds and notes outstanding—an increase of 12.0% over last year (see *Exhibit 8*). Note 13, in the notes to the financial statements, includes more detailed information about the State's long-term debt.

*Exhibit 8*  
**State of South Carolina's Outstanding Bonds and Notes**  
 (Expressed in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2001	2002	2001	2002	2001	2002
Backed by the State:						
General obligation bonds.....	\$ 2,054,526	\$ 2,204,129	\$ 96,310	\$ 134,235	\$ 2,150,836	\$ 2,338,364
Bond anticipation notes.....	—	—	—	8,400	—	8,400
Backed by specific revenues:						
Revenue bonds and notes.....	7,026	4,398	1,460,287	1,574,598	1,467,313	1,578,996
Infrastructure Bank bonds.....	832,575	1,193,046	—	—	832,575	1,193,046
Tobacco Authority bonds.....	934,530	902,920	—	—	934,530	902,920
Limited obligation bonds.....	34,003	30,597	—	—	34,003	30,597
Bond anticipation notes.....	—	—	—	16,400	—	16,400
<b>Total.....</b>	<b>\$ 3,862,660</b>	<b>\$ 4,335,090</b>	<b>\$ 1,556,597</b>	<b>\$ 1,733,633</b>	<b>\$ 5,419,257</b>	<b>\$ 6,068,723</b>

## Management's Discussion and Analysis

New debt resulted mainly from the issuance of \$371.020 million in Infrastructure Bank revenue bonds. The State Infrastructure Bank uses its own revenues to pay the principal and interest (*debt service*) on these bonds. These revenues are primarily truck registration fees and penalties that the Department of Public Safety collects and transfers to the Bank.

Three bond rating services assign ratings to bonds that the State backs with its own taxing authority (*general obligation bonds*). Standard & Poor's and Fitch, Inc., rate these bonds as "AAA," and Moody's Investors Service rates them as "Aaa." These are the highest ratings that these services assign. In January 2003, Standard & Poor's stated that its "AAA" rating reflected "a historically strong economy, good financial controls and monitoring, and low debt coupled with tightly controlled debt issuance guidelines."

The State limits the amount of annual payments for principal and interest on general obligation bonds and notes rather than directly limiting the amount of those bonds and notes that the State may have outstanding. At June 30, 2002, the State legally could issue additional bonds as long as the new debt would not increase the State's annual principal and interest payments by more than the following amounts: \$8.491 million in total for all institution bonds, \$19.925 million for highway bonds, and \$29.517 million for general obligation bonds, excluding institution and highway bonds. (*Institution bonds* are general obligation bonds that benefit the State's Higher Education Fund.)

### Economic Factors and Next Year's Budget

#### The "Rainy Day Account"

At June 30, 2002, the General Fund Reserve, sometimes called the *rainy day account*, had a zero balance instead of the \$152.410 million that would have been in the reserve had it been fully funded at that date. The State's Constitution requires restoration of the reserve to full funding within three years after a withdrawal. State law defines full funding for the reserve as 3% of the Budgetary General Fund's revenues for the latest completed accounting year. For additional information, see the schedule of General Fund Reserve activity in the *Supplementary Information* section of this report.

#### Budgetary General Fund for the 2002-2003 Accounting Year

As of February 10, 2003, the State's Board of Economic Advisors (BEA) had adjusted its estimate downward by a cumulative total of \$468.568 million (8.5%) from the Appropriation Act estimate for the 2002-2003 accounting year. The primary reason for these reductions was unrealistically large original revenue projections. The original revenue estimate for the 2002-2003 accounting year projected an 11.4% increase over the prior year's actual

collections, despite the fact that the General Assembly had enacted no tax increases.

As of February 11, 2003, the State Budget and Control Board had ordered a cumulative total of \$518.200 million in spending reductions for 2002-2003. These reductions included elimination of the entire \$101.606 million set-aside for capital and nonrecurring purposes and \$416.594 million (8.73%) budget cuts for State agencies.

See the *Budgetary General Fund Highlights* section above for additional information about the responsibilities of the BEA and the State Budget and Control Board.

### Economic Conditions

The following information is from materials published by the South Carolina Employment Security Commission. The State's unemployment rate decreased to 6.0% in December 2002, down from 6.3% in November. Nationally, the unemployment rate was at 6.0% as well.

In December, the number of non-farm workers in South Carolina dropped by 3,800 compared to November. Service workers declined by 3,900 (including a decline of 1,400 hotel and other lodging workers) due to the seasonal slowdown in tourism. Manufacturing continued its downward spiral, losing 2,200 jobs. One-half of these losses were concentrated in apparel and other textile businesses. On a more positive note, retailers added 1,400 workers to their December payroll, despite a slow Christmas sales season, and transportation and public utilities added 1,800 workers.

The economic outlook through June 2003 for South Carolina and the nation partially depends on maintaining and expanding consumer spending, which sustained the economy during the recession. Consumer spending has been stimulated by low interest rates and by generous dealer incentives and price discounts for large-ticket consumer items such as automobiles. Other factors such as the uncertainty of impending war and cutbacks in State government spending continue to adversely affect the State's economic situation. The Midlands area of South Carolina is being impacted by government cutbacks in spending and employment. In general, businesses must increase spending on capital assets and inventories to prepare for an expansion in the State's economy.

### Requests For Information

The primary purpose of this financial report is to provide South Carolina's citizens, taxpayers, customers, investors, and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. Please address your questions concerning information in this report as follows:

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Post Office Box 11228  
Columbia, South Carolina 29211